

DUTIES AND LIABILITIES OF DIRECTORS

OF

NATIONAL BANKS AND MEMBER BANKS OF THE FEDERAL RESERVE SYSTEM.

Sections of the United States Revised Statutes (National Bank and Federal Reserve Acts) which define certain duties of directors of national banks and member banks and prescribe penalties for neglect of such duties.

(SEC. 5145.) The affairs of each association shall be managed by not less than five directors, who shall be elected by the shareholders at a meeting to be held at any time before the association is authorized by the Comptroller of the Currency to commence the business of banking; and afterward at meetings to be held on such day in January of each year as is specified therefor in the articles of association. The directors shall hold office for one year, and until their successors are elected and have qualified.

Number and election of directors.

Term of office.

(SEC. 5146.) Every director must, during his whole term of service be a citizen of the United States, and at least three-fourths of the directors must have resided in the State, Territory, or District in which the association is located, for at least one year immediately preceding their election, and must be residents therein during their continuance in office. Every director must own, in his own right, at least ten shares of the capital stock of the association of which he is a director unless the capital of the bank shall not exceed twenty-five thousand dollars, in which case he must own in his own right at least five shares of such capital stock. Any director who ceases to be the owner of the required number of shares of the stock, or who becomes in any other manner disqualified, shall thereby vacate his place.

Qualifications of directors.

(SEC. 5147.) Each director, when appointed or elected, shall take an oath that he will, so far as the duty devolves on him, diligently and honestly administer the affairs of such association, and will not knowingly violate, or willingly permit to be violated, any of the provisions of this Title, and that he is the owner in good faith, and in his own right, of the number of shares of stock required by this Title, subscribed by him, or standing in his name on the books of the association, and that the same is not hypothecated, or in any way pledged, as security for any loan or debt. Such oath, subscribed by the director making it, and certified by the officer before whom it is taken, shall be immediately transmitted to the Comptroller of the Currency, and shall be filed and preserved in his office.

Oath required from directors.

(SEC. 5148.) Any vacancy in the board shall be filled by appointment by the remaining directors, and any director so appointed shall hold his place until the next election.

Vacancies, how filled.

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Limit of liabilities to an association of any person, firm, or corporation for money borrowed.

The discount of bills of exchange, etc., not money borrowed.

Deposits with non-member banks subject to loan limit.

Dividends and surplus fund.

Withdrawal of capital prohibited.

Dividend not to exceed net profits.

Bad debts defined.

Penalty for violation of provisions of this Title.

Violation, how determined.

(Sec. 5200.) The total liabilities to any association, of any person, or of any company, corporation, or firm for money borrowed, including, in the liabilities of a company or firm, the liabilities of the several members thereof, shall at no time exceed one-tenth part of the amount of the capital stock of such association actually paid in and unimpaired and one-tenth part of its unimpaired surplus fund: *Provided, however,* That the total of such liabilities shall in no event exceed thirty per centum of the capital stock of the association. But the discount of bills of exchange drawn in good faith against actually existing values, and the discount of commercial or business paper actually owned by the person negotiating the same, shall not be considered as money borrowed.

(Sec. 19, F. R. A., as amended Aug. 15, 1914.) If a State bank or trust company is required or permitted by the law of its State to keep its reserves either in its own vaults or with another State bank or trust company or with a national bank, such reserve deposits so kept in such State bank, trust company, or national bank shall be construed within the meaning of this section as if they were reserve deposits in a national bank in a reserve or central reserve city for a period of three years after the Secretary of the Treasury shall have officially announced the establishment of a Federal reserve bank in the district in which such State bank or trust company is situate. Except as thus provided, no member bank shall keep on deposit with any nonmember bank a sum in excess of ten per centum of its own paid-up capital and surplus. No member bank shall act as the medium or agent of a nonmember bank in applying for or receiving discounts from a Federal reserve bank under the provisions of this Act except by permission of the Federal Reserve Board.

(Sec. 5199.) The directors of any association may, semi-annually, declare a dividend of so much of the net profits of the association as they shall judge expedient; but each association shall, before the declaration of a dividend, carry one-tenth part of its net profits of the preceding half year to its surplus fund until the same shall amount to twenty per centum of its capital stock.

(Sec. 5204.) No association, or any member thereof, shall, during the time it shall continue its banking operations, withdraw, or permit to be withdrawn, either in the form of dividends or otherwise, any portion of its capital. If losses have at any time been sustained by any such association, equal to or exceeding its undivided profits then on hand, no dividend shall be made; and no dividend shall ever be made by any association, while it continues its banking operations, to an amount greater than its net profits then on hand, deducting therefrom its losses and bad debts. All debts due to any association, on which interest is past due and unpaid for a period of six months, unless the same are well secured, and in process of collection, shall be considered bad debts within the meaning of this section. But nothing in this section shall prevent the reduction of the capital stock of the association under section fifty-one hundred and forty-three.

(Sec. 5239.) If the directors of any national banking association shall knowingly violate, or knowingly permit any of the officers, agents, or servants of the association to violate any of the provisions of this Title, all the rights, privileges, and franchises of the association shall be thereby forfeited. Such violation shall, however, be determined and adjudged by a proper circuit, district, or territorial, court of the United States, in a suit brought for that

purpose by the Comptroller of the Currency, in his own name, before the association shall be declared dissolved. And in cases of such violation, every director who participated in or assented to the same shall be held liable in his personal and individual capacity for all damages which the association, its shareholders, or any other person shall have sustained in consequence of such violation.

Liability of directors
for violation.

(Sec. 5209.) Every president, director, cashier, teller, clerk, or agent of any association, who embezzles, abstracts, or willfully misapplies any of the moneys, funds, or credits of the association; or who, without authority from the directors, issues or puts in circulation any of the notes of the association; or who, without such authority, issues or puts forth any certificate of deposit, draws any order or bill of exchange, makes any acceptance, assigns any note, bond, draft, bill of exchange, mortgage, judgment, or decree; or who makes any false entry in any book, report, or statement of the association, with intent, in either case, to injure or defraud the association or any other company, body politic or corporate, or any individual person, or to deceive any officer of the association, or any agent appointed to examine the affairs of any such association; and every person who with like intent aids or abets any officer, clerk, or agent in any violation of this section, shall be deemed guilty of a misdemeanor, and shall be imprisoned not less than five years nor more than ten.

Penalty for embezzlement, making false entries in books, reports, etc.

(Sec. 22, F. R. A.) No member bank or any officer, director, or employee thereof shall hereafter make any loan or grant any gratuity to any bank examiner. Any bank officer, director, or employee violating this provision shall be deemed guilty of a misdemeanor and shall be imprisoned not exceeding one year or fined not more than \$5,000, or both; and may be fined a further sum equal to the money so loaned or gratuity given. Any examiner accepting a loan or gratuity from any bank examined by him or from an officer, director, or employee thereof shall be deemed guilty of a misdemeanor and shall be imprisoned not exceeding one year or fined not more than \$5,000, or both; and may be fined a further sum equal to the money so loaned or gratuity given; and shall forever thereafter be disqualified from holding office as a national-bank examiner. No national-bank examiner shall perform any other service for compensation while holding such office for any bank or officer, director, or employee thereof.

Prohibits loans to any bank examiner and the payment of other than usual fee or salary to directors, officers, or employees.

Other than the usual salary or director's fee paid to any officer, director, or employee of a member bank and other than a reasonable fee paid by said bank to such officer, director, or employee for services rendered to such bank, no officer, director, employee, or attorney of a member bank shall be a beneficiary of or receive, directly or indirectly, any fee, commission, gift, or other consideration for or in connection with any transaction or business of the bank. No examiner, public or private, shall disclose the names of borrowers or the collateral for loans of a member bank to other than the proper officers of such bank without first having obtained the express permission in writing from the Comptroller of the Currency, or from the board of directors of such bank, except when ordered to do so by a court of competent jurisdiction, or by direction of the Congress of the United States, or of either House thereof, or any committee of Congress or of either House duly authorized. Any person vio-

lating any provision of this section shall be punished by a fine of not exceeding \$5,000 or by imprisonment not exceeding one year, or both.

Except as provided in existing laws, this provision shall not take effect until sixty days after the passage of this Act.

Act approved January 26, 1907.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That it shall be unlawful for any national bank, or any corporation organized by authority of any laws of Congress, to make a money contribution in connection with any election to any political office. It shall also be unlawful for any corporation whatever to make a money contribution in connection with any election at which Presidential and Vice-Presidential electors or a Representative in Congress is to be voted for or any election by any State legislature of a United States Senator. Every corporation which shall make any contribution in violation of the foregoing provisions shall be subject to a fine not exceeding five thousand dollars, and every officer or director of any corporation who shall consent to any contribution by the corporation in violation of the foregoing provisions shall upon conviction be punished by a fine of not exceeding one thousand and not less than two hundred and fifty dollars, or by imprisonment for a term of not more than one year, or both such fine and imprisonment in the discretion of the court.

Sections of "An act to supplement existing laws against unlawful restraints and monopolies, and for other purposes," approved October 15, 1914.

Prohibiting one person from being a director or other officer or employee of more than one bank under certain conditions.

SEC. 8. That from and after two years from the date of the approval of this Act no person shall at the same time be a director or other officer or employee of more than one bank, banking association or trust company, organized or operating under the laws of the United States, either of which has deposits, capital, surplus, and undivided profits aggregating more than \$5,000,000; and no private banker or person who is a director in any bank or trust company, organized and operating under the laws of a State, having deposits, capital, surplus, and undivided profits aggregating more than \$5,000,000, shall be eligible to be a director in any bank or banking association organized or operating under the laws of the United States. The eligibility of a director, officer, or employee under the foregoing provisions shall be determined by the average amount of deposits, capital, surplus, and undivided profits as shown in the official statements of such bank, banking association, or trust company filed as provided by law during the fiscal year next preceding the date set for the annual election of directors, and when a director, officer, or employee has been elected or selected in accordance with the provisions of this Act it shall be lawful for him to continue as such for one year thereafter under said election or employment.

No bank, banking association or trust company, organized or operating under the laws of the United States, in any city or incorporated town or village of more than two hundred thousand inhabitants, as shown by the last preceding decennial census of the United States, shall have as a director or other officer or employee any private banker or any director or other officer or employee of any other bank, banking association or trust company located in the same place: *Provided*, That nothing in this section shall apply to mutual savings banks not having a capital stock represented by shares: *Provided further*, That a director or other officer or employee of such bank, banking association, or trust company may be a director or other officer or employee of not more than one other bank or trust company organized under the laws of the United States or any State where the entire capital stock of one is owned by stockholders in the other: *And provided further*, That nothing contained in this section shall forbid a director of class A of a Federal reserve bank, as defined in the Federal Reserve Act, from being an officer or director or both an officer and director in one member bank.

That from and after two years from the date of the approval of this Act no person at the same time shall be a director in any two or more corporations, any one of which has capital, surplus; and undivided profits aggregating more than \$1,000,000, engaged in whole or in part in commerce, other than banks, banking associations, trust companies and common carriers subject to the Act to regulate commerce, approved February fourth, eighteen hundred and eighty-seven, if such corporations are or shall have been theretofore, by virtue of their business and location of operation, competitors, so that the elimination of competition by agreement between them would constitute a violation of any of the provisions of any of the antitrust laws. The eligibility of a director under the foregoing provision shall be determined by the aggregate amount of the capital, surplus, and undivided profits, exclusive of dividends declared but not paid to stockholders, at the end of the fiscal year of said corporation next preceding the election of directors, and when a director has been elected in accordance with the provisions of this Act it shall be lawful for him to continue as such for one year thereafter.

When any person elected or chosen as a director or officer or selected as an employee of any bank or other corporation subject to the provisions of this Act is eligible at the time of his election or selection to act for such bank or other corporation in such capacity his eligibility to act in such capacity shall not be affected and he shall not become or be deemed amenable to any of the provisions hereof by reason of any change in the affairs of such bank or other corporation from whatsoever cause, whether specifically excepted by any of the provisions hereof or not, until the expiration of one year from the date of his election or employment.

Sec. 11. That authority to enforce compliance with sections two, three, seven and eight of this Act by the persons respectively subject thereto is hereby vested: in the Interstate Commerce Commission where applicable to common carriers, in the Federal Reserve Board where applicable to banks, banking

Authority to enforce
above section.

associations and trust companies, and in the Federal Trade Commission where applicable to all other character of commerce, to be exercised as follows:

CIVIL LIABILITY OF DIRECTORS.

Decisions of the Federal courts as to the nature and extent of the civil liability of directors of national banks.

Liability of directors
for making and pub-
lishing false report.

Under the decisions of the Supreme Court of the United States in *Thomas v. Taylor* (224 U. S., 73) and of the United States Circuit Court of Appeals in *Chesbrough et al. v. Woodworth* (195 Fed. Rep., 875), when the Comptroller of the Currency has notified directors to collect or charge off certain assets it is a warning that those assets are doubtful, and to disregard such a notice and represent the assets in a statement to be good is a violation of law and renders the directors making the statement liable for damages to one deceived thereby.

The Circuit Court of Appeals in the latter case held that while the duty of charging off such worthless paper was that of the board of directors as an entity, and in such matter the board had a reasonable discretion, yet when the duty existed and was wholly unperformed an individual director who is engaged generally in the performance of his functions may be personally liable because of his participation in the failure to act by failing to make reasonable personal efforts to induce the proper action.

In the case referred to (*Chesbrough et al. v. Woodworth*) the plaintiff bought stock in the bank in reliance upon a false report of its condition and had suffered damage thereby. He was held to have a right of action against any officer or director who knowing its falsity had authorized such a report. The court held that the measure of the plaintiff's recovery would be the difference in the fair valuation of his stock if all of the paper had been of a character entitling it to be reported as assets and that sum which would have been a fair minimum valuation if the directors in the exercise of due care and good faith had charged off the books and not reported so much of the paper as they knew or had good reason to believe was not good and collectible.

LIABILITY OF DIRECTORS FOR MISMANAGEMENT.

Degree of care re-
quired of directors.

The Supreme Court of the United States has held (*Briggs v. Spaulding*, 141 U. S., 132) that directors of a national bank must exercise ordinary care and prudence in the administration of the affairs of a bank, and this includes something more than officiating as figureheads. They are entitled under the law to commit the banking business, as defined, to their duly authorized officers; *but this does not absolve them from the duty of reasonable supervision, nor ought they to be permitted to be shielded from liability because of want of knowledge of wrongdoing, if that ignorance is the result of gross inattention.*

It was further held in the same case that the degree of care required of directors of corporations depends upon the subject to which it is to be applied, and each case is to be determined in view of all the circumstances; that the directors of a corporation are not insurers of the fidelity of the agents whom

they appoint and they can not be held responsible for losses resulting from the wrongful acts or omissions of other directors or agents unless the loss is a consequence of their own *neglect of duty*.

The United States Circuit Court held (*Rankin v. Cooper et al.*, 149 Fed. Rep., 1010) that it is the duty of directors of a national bank to exercise reasonable control and supervision over its affairs, and to use ordinary care and diligence in ascertaining the condition of its business, which is such care as an ordinarily prudent and diligent man would exercise in view of all the circumstances; and that where the directors of a national bank became aware, through the report of a committee of their number, and also by notices sent them individually by the Comptroller of the Currency, that the bank had been making excessive loans to its president and to other persons, firms, and corporations with which he was associated, but took no effective steps to reduce such loans, or to prevent their increase, which continued until the bank became insolvent, *they will be held jointly and severally liable for all losses which the bank sustained through subsequent transactions, and which could have been prevented by a proper discharge of their duties.*

The United States Circuit Court has held (*Witters, Receiver, etc., v. Sowles et al.*, 31 Fed. Rep., 1) that under Revised Statutes, section 5200, directors of a national bank who make or assent to the making of a loan to any one person of a sum exceeding the legal limit *become personally and individually liable for all loss sustained thereby*; but where the borrower in such a case is also one of the directors he is not so liable, but simply as a debtor to the bank.

*Liability of directors
for assenting to ex-
cessive loans.*

